

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0077
Sales and Use Tax
For The Tax Periods: 1993 through 1995**

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ISSUES

I. Use Tax – Manufacturing Exemption: Lab and Water Treatment Chemicals

Authority: IC 6-2.5-3-2, IC 6-8.1-5-1, 45 IAC 2.2-5-70, 45 IAC 2.2-5-8.

Taxpayer protests amount of use tax assessed on its purchase of water treatment chemicals.

II. Use Tax – Manufacturing Exemption: Equipment

Authority: IC 6-2.5-3-2, IC 6-2.5-5-3, 45 IAC 2.2-5-8.

Taxpayer protests use tax assessed on its scales, balers and conveyers.

STATEMENT OF FACTS

Taxpayer is engaged in the business of recycling of waste paper. The paper is collected and processed into packaged rolls for use by its customers. Additional facts will be provided as needed.

I. Use Tax – Manufacturing Equipment Exemption: Water Treatment Chemicals

DISCUSSION

During the audit, Taxpayer was assessed use tax on their purchases of lab and water treatment items. Taxpayer states that the purchases are exempt because they are used to comply with local environmental quality standards and/or that the supplies are used in the production process.

Indiana imposes “an excise tax, known as the use tax, on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or the retail merchant making that transaction.” IC 6-2.5-3-2.

Taxpayer contends that 90% of the water is discharged into the local sewer system and is not re-used and the remaining 10% is treated and re-utilized in the pulping or production process.

Taxpayer claims that the 90% of the water which is discharged into the municipal sewer system is required to meet certain specifications. In order to ensure the water meets these specifications the water must be treated and tested. Pursuant to 45 IAC 2.2-5-70:

The state gross retail tax does not apply to sales of tangible personal property which constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local or federal environmental quality statutes, regulations or standards; and the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Taxpayer goes on to argue that the remaining 10% of the water is re-utilized after testing and treatment. They state that the water is constantly processed and re-introduced into the pulping process and if it were not treated could not be used in the production process. 45 IAC 2.2-5-8(c) states:

the state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment that are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

The audit notes that the testing of the water is performed after the production process is complete and before the water is used again in the first operation. The water is not used in production at the time it is being treated. Rather, the treatment takes place prior to its use. Consequently, it is not directly used in the direct production of the recycled paper. In addition, Taxpayer does not provide documentation verifying how they came up with their percentages used in their breakdown. "The notice of proposed assessment is *prima facie evidence* that the department's claim for unpaid tax is valid, and the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1 (emphasis added). Taxpayer's protest must be denied.

FINDING

Taxpayer's protest is denied.

II. Use Tax – Manufacturing Exemption: Equipment

DISCUSSION

Taxpayer protests the assessment of use tax upon their scales, compactor, baler and upender/conveyor system. The auditor assessed these items after determining that they were either used before or after the production process.

Taxpayer contends that these items should be exempt from the gross retail tax in accordance with 45 IAC 2.2-5-8.

As stated above, “an excise tax, known as the use tax, on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or the retail merchant making that transaction.” IC 6-2.5-3-2.

However, an exemption is allowed for certain tools used in the production process. IC 6-2.5-5-3(b) states:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

More specifically, 45 IAC 2.2-5-8(c) states:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment that are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

In addition, 45 IAC 2.2-5-8(d) states:

Pre-production and post-production activities. “Direct use in the production process” begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Taxpayer argues that the production process begins with the weighing of the raw waste paper used the system. The scale and foundation are utilized to ensure that the proper amounts of waste paper are collected for introduction into the system. Taxpayer states that the scales measure the cardboard and waste to achieve the proper percentages when it is boiled. Taxpayer compares these scales to the example of exempt items described in 45 IAC 2.2-5-8(c)(2)(G). There, the regulation states that “[a]n automated scale process which measures quantities of raw aluminum for use in the next production step of the casting process in the foundry” is exempt. *Id.* Taxpayer argues that the introduction of the raw waste materials to be boiled is similar to the above referenced example.

Taxpayer also argues that the compactor/conveyor and baler is used to compress loose waste paper into a dense format for processing. The recycling system requires large, but controlled quantities of specific types of waste paper. Taxpayer goes on to state that if the waste paper is

not in a dense compressed form or a “baled” form it cannot be introduced at a sufficient rate and the equipment is not designed to handle loose, uncompressed waste paper.

Finally, Taxpayer argues that the upending and movement of the banded rolls or recycled paper is also an essential and integral step in processing of the final product. Taxpayer notes that the upending and conveyance of paper rolls occurs within the plant after the rolls are banded, but prior to the final wrapping. The upender/conveyor helps move the rolls in order that they may be wrapped and labeled prior to shipping.

The Department finds that the process at issue begins with the first step in altering the material to its completed form, which is the boiling of the waste material. The regulation cited by taxpayer references a weighing and measuring step within an integrated process, not prior to the process starting. The Department also finds that the production process ends with the banding of the rolls, a point that the production has altered the item to its completed form, including required packaging.

FINDING

Taxpayer’s protest is respectfully denied.